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THE AUDIT OF HANDLERS' RECORDS IN CONNECTION WITH
FEDERAL REGULATION OF MILK MARKETING

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AGRICULTURAL ADJUSTMENT ADMINISTRATION

Division of Marketing and Marketing Agreements
Dairy Section

December 1937.

TABLE OF CONTENTS

Section	Page
I The Purpose of the Outside Audit	1
II Auditing Experience in the Boston Market	2
1. Auditing procedure	3
2. Types of audit adjustments	3
3. Base and excess adjustments	5
4. Class utilization adjustments	5
III Handler Practices in Absence of Outside Audit	10
1. Use in higher class than reported	12
2. Standardizing and reconstructing milk	13
3. Interhandler sales	15
4. Conclusion of Federal Trade Commission regarding handler reports and audits	15
IV Compatibility of Government Audit with Handlers' Interest in Privacy of Records	17

INTRODUCTION

This paper is designed to set forth the necessity for an audit of handlers' sales and purchase records in any milk market operating under a classified price plan. It is in part an analysis of the audit adjustments made in the Boston market pursuant to findings by the office of the Federal market administrator undertaken during the period from March 16, 1934 to July 31, 1936, and in part a recapitulation of data and information published by the Federal Trade Commission in its reports of the results of investigations undertaken pursuant to House Resolution No. 32, 73d Congress, Second Session.

THE AUDIT OF HANDLERS' RECORDS IN CONNECTION
WITH FEDERAL REGULATION OF MILK MARKETING

I

THE PURPOSE OF THE OUTSIDE AUDIT

In the fluid milk markets of the country the predominant system of marketing is that based upon collective agreements between organized producers and handlers whereby milk is purchased by the latter under some form of classified price plan.^{1/} Such a plan involves varying rates of payment for milk, depending upon the handlers' disposal of the product on the fluid milk market or on any one of the so-called milk product markets, such as those for cream, butter, cheese, or condensed milk.

Under the classified price plan of payment for milk a thorough audit of the books and records of dealers is essential. It is only by keeping complete accounts of their sales of milk in the several classes and submitting them periodically for inspection by the agents of producers, or, in markets under governmental regulation, the market administrator, that the handlers are able to prove that they have faithfully carried out the terms of the price plan in the agreement or order. If these records are not open for outside inspection, only the handlers themselves have knowledge concerning the extent to which they have complied with or have violated their agreements. Each handler is without knowledge of the violations committed by others, and has no assurance that he will not be penalized, if he carries out the terms of the agreement, by the evasions of his competitors. In the case of voluntary agreements between handlers and producers, producers are often in the position of having to accept on faith the handlers' reports of their disposal of milk in the various classes, and they can never be certain that any advantage which they may gain in prices will not be partly offset by the noncompliance of handlers. In markets under State or Federal regulation, an audit of distributors' sales and receipts is necessary in order to insure a uniform and impartial interpretation of the rules and regulations of the market, as well as proper accounting for milk

^{1/} In markets where State or Federal supervision is established, orders may take the place of producer-handler collective bargaining agreements, but the type of classified price plan which has evolved in each market is not fundamentally altered.

by handlers pursuant to the provisions of the classified price plan set forth in the order.

The Agricultural Marketing Agreement Act of 1937, under the authority of which the Federal supervision of numerous milk markets is carried out, contains the following provision relating to the examination of books and records:

"All parties to any marketing agreement and all handlers subject to an order, shall severally, from time to time, upon the request of the Secretary, furnish him with such information as he finds to be necessary to enable him to ascertain and determine the extent to which such agreement or order has been carried out or has effectuated the declared policy of this title, and with such information as he finds to be necessary to determine whether or not there has been any abuse of the privilege of exemptions from the antitrust laws. Such information shall be furnished in accordance with forms of reports to be prescribed by the Secretary. For the purpose of ascertaining the correctness of any report made to the Secretary pursuant to this subsection, or for the purpose of obtaining the information required in any such report, where it has been requested and has not been furnished, the Secretary is hereby authorized to examine such books, papers, records, copies of income-tax reports, accounts, correspondence, contracts, documents, or memoranda, as he deems relevant and which are within the control (1) of any such party to such marketing agreement, or any such handler, from whom such report was requested or (2) of any person having, either directly or indirectly, actual or legal control of or over such party or such handler or (3) of any subsidiary of any such party, handler, or person."^{2/}

The milk control laws enacted by the various State legislatures likewise contain provision for access to handlers' records by the control board or other agency designated to administer the act.^{3/}

II

AUDITING EXPERIENCE IN THE BOSTON MARKET

The administrative function of the audit in a market which is under Government supervision can be illustrated by a record of actual experience

^{2/} This section was included in the Agricultural Adjustment Act, as amended in August 1935, which was amended and reenacted by the Agricultural Marketing Agreement Act of 1937.

^{3/} The Dairy Section of the Agricultural Adjustment Administration is publishing a series of papers summarizing the provisions of the various State Milk Control Acts. The acts for the following States which have thus far been summarized all contain provision for access to handlers' books and records: Indiana, Alabama, Connecticut, California, New Jersey, Virginia, New York, Pennsylvania, Rhode Island, Vermont, Massachusetts, and New Hampshire

in its use. For this purpose the Dairy Section of the Agricultural Adjustment Administration secured from the market administrator of the Boston marketing area a report analyzing the adjustments arising from audits of handlers' records. The report covers the period from March 16, 1934, to July 31, 1936. During this entire period Federal supervision was exercised in the Boston market, the provisions of License No. 38, issued under the original Agricultural Adjustment Act, being in operation until February 9, 1936, and those of Order No. 4, issued under the act as amended in 1935, being in force from this date to the end of the period.

1. Auditing procedure.- The marketing arrangements which were provided for in the Boston market during this period included (1) a classified price plan of payment for milk by handlers, and (2) a market-wide pool with base rating used in prorating to producers the proceeds of sales to distributors. Two classes of milk were established in the market; Class I - fluid whole milk (including chocolate or flavored milk) sold for consumption as milk, and Class II - all other milk, which in this market consisted almost wholly of milk sold for use as fluid cream.

The books of handlers were subject to a semimonthly audit by the market administrator to determine, (1) the correctness of their payments for milk in accordance with their class utilization, and (2) the correctness of payments to producers under the market-wide pool. Adjustment accounts were maintained by the market administrator for each handler by debiting him with the amount which he was obligated to pay for his milk and crediting him with the amount which his producers received from the market-wide pool. Balances on the handlers' accounts were settled with the market administrator.

2. Types of audit adjustments.- The semimonthly audit of the books and records of handlers gave rise to two main classes of adjustments; (1) those due to handlers' errors in reporting producers' base and excess milk, and (2) those due to handlers' errors in reporting their Class I and Class II utilization of milk. Auditing adjustments of the first type did not alter the handler's cost of milk. They were made necessary because the handler had paid too much or too little to some of his producers with corresponding discrepancies in payments to and from the pool. The adjustment involved debits or credits to handlers which were collectible from or payable to the particular producers involved. However, those auditing adjustments which were due to errors of handlers in reporting their class utilization had a direct bearing upon the amount which such handlers paid for their milk and hence affected the total returns to producers.

Auditing adjustments of both types made in the Boston market during the period from March 16, 1934, to July 31, 1936, are summarized in table 1. The average debit and credit adjustment for a single audit period (15 days) was \$8,662.06 - debits averaging \$5,534.81 and credits averaging \$3,127.25. The debit balance of base and excess adjustments for all handlers averaged \$957.12, debits amounting to \$2,804.85 and credits amounting to \$1,847.73. The debit balance of Class I and Class II

Table 1.- BOSTON, MASS.- Summary of audit adjustments,
March 16, 1934, to July 31, 1936

Type of adjustment	Amount	
	Total	Average ^{1/}
	<u>Dollars</u>	<u>Dollars</u>
Base and excess adjustments:		
Net debits to individual handlers	159,876.43	2,804.85
Net credits to individual handlers	<u>105,320.70</u>	<u>1,847.73</u>
Net debits - all handlers	54,555.73	957.12
Class I and Class II adjustments:		
Net debits to individual handlers	155,607.52	2,729.96
Net credits to individual handlers	<u>72,932.66</u>	<u>1,279.52</u>
Net debits - all handlers	82,674.86	1,450.44
Total audit adjustments:		
Net debits to individual handlers	315,483.95	5,534.81
Net credits to individual handlers	<u>178,253.36</u>	<u>3,127.25</u>
Net debits - all handlers	137,230.59	2,407.56

^{1/} Average per semi monthly auditing period.

Compiled from records in the office of the market administrator.

adjustments for all handlers averaged \$1,450.44, debits amounting to \$2,729.96 and credits amounting to \$1,279.52. During the entire period of the report, which covered 28 1/2 months, audit adjustments totaling \$493,737.31 were made, of which \$315,483.95 were debits and \$178,253.36 were credits. From the standpoint of the administrative value of the audit, the total adjustments are of more significance than the balance of credits or debits. Even if credits and debits had approximately balanced, inequities among handlers and among producers would have been corrected by means of the audit adjustments.

3. Base and excess adjustments.- The debit balance of \$54,555.73 on base and excess adjustments, as shown in table 1, is mainly attributable to unusually large debits in the early periods of 1934. These were due to the estimating of base deliveries and the reporting of deliveries of large blocks of producers as base milk before they had earned base ratings under the license. Subsequently there was a tendency for base and excess credits to exceed debits due to a lag in taking account of increased base ratings. However, the study indicates that in periods when base ratings were not being increased net debit balances on this type of adjustment would probably result. These would be due to a general tendency for handlers to favor their own producers with larger payments from the market-wide pool than they were entitled to receive under a strict interpretation of the rules.

The record of all base and excess adjustments and net balances by periods is shown in table 2. Credit balances are shown to have occurred in 36 of the 57 audit periods. The majority of the periods showed substantial adjustments of both debits and credits, 52 periods or 91 percent of the total showing debit adjustments of more than \$500 and 51 periods or 89 percent of the total showing credit adjustments of more than this amount.

4. Class utilization adjustments.- As was indicated above, audit adjustments, arising from the failure of handlers to report correctly their class utilization of milk, are very important from the standpoint of insuring that handlers pay the total use value of their milk in accordance with the classified price plan specified in the order. Table 1 shows that during the entire period studied, debit adjustments of this type amounted to \$155,607.52 and the net balance of debits amounted to \$82,674.86, the net amount which handlers would have underpaid producers in the absence of audit of their records. This meant that individual producers were reimbursed to the amount of \$155,607.52 and producers as a class were reimbursed to the amount of \$82,674.86 through the audit of handlers' books and records in the Boston market. The difference between these two amounts, \$72,932.66, represents credit adjustments which, if not corrected, would have represented overpayment by handlers.

The record of all class utilization adjustments and net balances by periods is shown in table 3. Debit balances are shown to have occurred

Table 2.- BOSTON, MASS.- Base and excess adjustments by audit periods from March 16, 1934, to July 31, 1936

Period ^{1/}	Debits	Credits	Net debit or credit (-)
	Dollars	Dollars	Dollars
March 16-31, 1934	12,269.98	1,721.64	10,548.34
April 1-15	10,835.88	1,244.01	9,591.87
16-30	10,553.64	920.80	9,632.84
May 1-15	21,843.59	2,299.70	19,543.89
16-31	24,519.39	2,660.18	21,859.21
June 1-15	18,431.48	2,185.26	16,246.22
16-30	4,333.63	2,374.65	1,958.98
July 1-15	3,924.19	1,504.66	2,419.53
16-31	2,761.70	2,526.35	235.35
Aug. 1-15	2,098.75	2,941.31	-842.56
16-31	1,007.40	3,454.32	-2,446.92
Sept. 1-15	3,757.79	4,177.53	-419.74
16-30	2,014.60	3,745.32	-1,730.72
Oct. 1-15	974.64	3,092.59	-2,117.95
16-31	1,950.86	4,542.34	-2,591.48
Nov. 1-15	1,405.68	3,740.77	-2,335.09
16-30	986.49	845.98	140.51
Dec. 1-15	805.24	427.92	377.32
16-31	958.20	390.40	567.80
Jan. 1-15, 1935	1,306.59	1,521.80	-215.21
16-31	1,578.16	1,246.95	331.21
Feb. 1-15	991.01	1,324.90	-333.89
16-28	791.79	7,592.35	-6,800.56
March 1-15	1,369.90	9,225.43	-7,855.53
16-31	2,137.97	1,431.85	706.12
April 1-15	1,101.57	1,536.15	-434.58
16-30	1,454.79	1,317.17	137.62
May 1-15	1,199.54	1,303.33	-103.79
16-31	1,342.19	1,688.63	-346.44
June 1-15	1,235.37	1,744.86	-509.49
16-30	1,234.45	1,582.56	-348.11
July 1-15	1,040.18	3,162.10	-2,121.92
16-31	1,376.60	1,381.52	-4.92
Aug. 1-15	1,296.74	1,596.77	-300.03
16-31	923.66	2,529.94	-1,606.28

(Continued)

Table 2.- BOSTON, MASS.- Base and excess adjustments by audit periods from March 16, 1934, to July 31, 1936 (Continued)

Period ^{1/}	Debits	Credits	Net debit or credit (-)
	Dollars	Dollars	Dollars
Sept. 1-15	707.77	808.12	-100.35
16-30	1,638.43	682.90	955.53
Oct. 1-15	687.96	796.89	-108.93
16-31	544.55	725.42	-180.87
Nov. 1-15	388.39	644.19	-255.80
16-30	636.96	527.22	109.74
Dec. 1-15	465.75	476.37	-10.62
16-31	733.01	520.53	212.48
Jan. 1-15, 1936	592.05	235.08	356.97
16-31	1,426.07	220.02	1,206.05
Feb. 1-15	542.07	1,006.95	-464.88
16-29	156.76	1,659.49	-1,502.73
March 1-15	287.88	2,297.53	-2,009.65
16-31	369.68	2,005.69	-1,636.01
April 1-15	600.70	1,546.80	-946.10
16-30	568.88	1,159.54	-590.66
May 1-15	557.98	1,263.74	-705.76
16-31	710.81	754.32	-43.51
June 1-15	710.24	979.22	-268.98
16-30	603.01	653.06	-50.05
July 1-15	505.88	882.25	-376.37
16-31	627.96	493.33	134.63
Total	159,876.43	105,320.70	54,555.73

^{1/} License No. 38 in effect from March 16, 1934 to February 8, 1936, Order No. 4 in effect from February 9, 1936, to July 31, 1936.

Compiled from records in the office of the market administrator.

Table 3.- BOSTON, MASS.- Class utilization adjustments by
audit periods from March 16, 1934,
to July 31, 1936

Period ^{1/}	Debits	Credits	Net debit or credit (-)
	<u>Dollars</u>	<u>Dollars</u>	<u>Dollars</u>
March 16-31, 1934	2,553.60	7,583.73	-5,030.13
April 1-15	2,472.63	6,326.89	-3,854.26
16-30	1,909.17	6,256.77	-4,347.60
May 1-15	3,552.97	3,130.93	422.04
16-31	3,313.24	1,974.73	1,338.51
June 1-15	3,068.79	1,410.71	1,658.08
16-30	3,002.48	1,431.95	1,570.53
July 1-15	2,895.67	1,219.04	1,676.63
16-31	3,241.42	1,728.38	1,513.04
Aug. 1-15	2,980.23	572.32	2,407.91
16-31	3,367.66	770.53	2,597.13
Sept. 1-15	4,208.91	2,232.41	1,976.50
16-30	4,600.17	645.78	3,954.39
Oct. 1-15	4,424.17	441.44	3,982.73
16-31	4,616.49	1,720.12	2,896.37
Nov. 1-15	4,818.50	731.88	4,086.62
16-30	2,422.95	785.86	1,637.09
Dec. 1-15	1,887.68	1,816.76	70.92
16-31	1,389.96	653.98	735.98
Jan. 1-15, 1935	1,582.81	868.87	713.94
16-31	1,677.18	812.59	864.59
Feb. 1-15	1,839.08	793.94	1,045.14
16-28	8,569.23	682.89	7,886.34
March 1-15	9,853.91	774.22	9,079.69
16-31	2,414.97	1,809.90	605.07
April 1-15	1,096.90	687.66	409.24
16-30	1,275.16	777.02	498.14
May 1-15	758.76	529.37	229.39
16-31	1,221.53	605.82	615.71
June 1-15	1,100.45	620.28	480.17
16-30	2,727.29	638.91	2,088.38
July 1-15	5,743.80	2,794.70	2,949.10
16-31	4,277.24	1,331.11	2,946.13
Aug. 1-15	3,012.96	1,008.59	2,004.37
16-31	5,783.23	947.82	4,835.41

(Continued)

Table 3.- BOSTON, MASS.- Class utilization adjustments by
audit periods from March 16, 1934,
to July 31, 1936 (Continued)

Period ^{1/}	Debits	Credits	Net debit or credit (-)
	<u>Dollars</u>	<u>Dollars</u>	<u>Dollars</u>
Sept. 1-15	1,774.87	594.61	1,180.26
16-30	2,368.53	1,308.45	1,060.08
Oct. 1-15	1,375.03	486.23	888.80
16-31	1,870.86	1,524.81	346.05
Nov. 1-15	1,902.60	732.36	1,170.24
16-30	1,575.02	508.44	1,066.58
Dec. 1-15	1,477.76	225.83	1,251.93
16-31	987.99	1,374.37	-386.38
Jan. 1-15, 1936	531.08	211.02	320.06
16-31	1,002.12	404.70	597.42
Feb. 1-15	1,486.47	341.12	1,145.35
16-29	1,474.20	304.10	1,170.10
March 1-15	2,914.81	507.29	2,407.52
16-31	5,278.55	636.26	4,642.29
April 1-15	1,146.74	921.73	225.01
16-30	1,063.56	267.40	796.16
May 1-15	1,455.07	493.79	961.28
16-31	1,647.02	284.05	1,362.97
June 1-15	4,649.86	1,989.75	2,660.11
16-30	2,612.64	1,042.23	1,570.41
July 1-15	1,889.32	678.47	1,210.85
16-31	1,462.23	977.75	484.48
Total	155,607.52	72,932.66	82,674.86

^{1/} License No. 38 in effect from March 16, 1934, to February 8, 1936. Order No. 4 in effect from February 9, 1936, to July 31, 1936.

Compiled from records in the office of the market administrator.

in all but four of the 57 audit periods. Debits of more than \$1,000 occurred in 54 periods, 29 of these, or slightly more than half of the total, showing debits of \$2,000 or more.

The sources of handlers' errors in reporting their class utilization of milk were analyzed for the period from February 9 to July 31, 1936, and the results are set forth in table 4. Two types of adjustment are seen to account for more than half (52 percent) of the total debit balance of \$17,858.18. These were (1) errors due to handlers' reporting Class II sales of milk without proof of Class II use, and (2) the reporting as Class II of cream used in standardizing.

Clerical errors required relatively large adjustments in the reports of handlers, although in the aggregate the debits and credits tended to balance. The total of debit and credit adjustments of this type for the period was larger than for any other, amounting to \$10,506.30. Other important types of errors corrected by the audit adjustments were due to: the incorrect reporting by handlers, of the market in which Class I milk was sold; the treatment by handlers of their purchases from producers as if they were from other handlers; the giving of milk to employees; and the reporting of sales of milk as skim without required affidavits.

It is interesting to note that although the above analysis of the auditing experience in the Boston market reveals that the audit of handler's books resulted in offsetting the tendency for handlers to favor themselves in their interpretations of the market regulations, the audit also resulted in sizable reimbursements to handlers to correct errors in their reports which, in the absence of an audit, would have resulted in loss to themselves. Credits to handlers' accounts due to Class I and Class II audit adjustments totaled \$72,932.66, or an average of \$1,279.52 for a 15-day audit period. In other words, distributors would have underpaid producers in the sum of \$155,607.52 and would have overpaid producers in the sum of \$72,932.66. The net underpayment would have amounted to \$82,674.86 had not the books of handlers been audited and handlers been required to reimburse producers in the amount of their underpayment.^{4/}

III

HANDLER PRACTICES IN ABSENCE OF OUTSIDE AUDIT

Recent evidence concerning practices of handlers when their records are not subject to a thorough audit by agents of producers or of some impartial third party has been brought out through the investigations of the Federal Trade Commission. These investigations were made under the authority of House Concurrent Resolution 32, Seventy-third Congress, second session, which directed the Commission to investigate conditions in the sale and distribution of milk and other dairy products. Among the matters which the Commission was particularly directed to determine was whether any operator in the market "is using any unfair method of competition in connection with the sale or distribution of any such dairy

^{4/} The figures given in this section do not represent complete coverage of the market, inasmuch as the books of handlers not in compliance with the license and order were not audited.

Table 4.- BOSTON, MASS.-Class I and Class II audit adjustments
by type, February 9 to July 31, 1936

Type of adjustment	Debits	Credits	Net debit or credit (-)	
			Amount	Percent
	<u>Dollars</u>	<u>Dollars</u>	<u>Dollars</u>	
1. Reported correctly as Class I with incorrect report of the market in which sold.....	78.09	1,065.93	-987.89	-5.5
2. Purchases from producers treated as from other handlers.....	1,143.34		1,143.34	6.4
3. Due to other errors in reporting purchases from producers.....	1,485.11	588.81	896.30	5.0
4. Milk given to employees.....	1,658.55		1,658.55	9.3
5. Skim sales without affidavits.....	2,218.37	836.18	1,382.19	7.7
6. Reported Class II sales of milk without proof of Class II use.....	5,594.95	170.11	5,424.84	30.4
7. Cream used in standardizing.....	3,864.18		3,864.18	21.6
8. Clerical errors.....	5,127.04	5,379.26	-252.22	-1.4
9. Purchases from handlers outside milkshed reported as from other handlers ^{1/}	944.57		944.57	5.3
10. Unallowable deduction of 2% of gross Class I sales for shrinkage ^{1/}	940.11		940.11	5.3
11. Flood period purchases for other markets treated as purchases from other handlers ^{2/}	604.53		604.53	3.4
12. Flood period special sales to chain stores not reported ^{2/}	351.68		351.68	2.0
13. Incorrect outside market sales reports (other than those included in the above classifications).....	2,814.25	845.42	1,968.83	11.0
14. Sundry items.....		80.83	-80.83	-.5
Totals.....	26,824.77	8,966.59	17,858.18	100.0

^{1/} In March 1-15 period.

^{2/} In March 16-31 period.

Compiled from records in the office of the market administrator.

products, or is in any way operating to depress the price of milk sold by producers."^{5/} Among the markets covered by the Commission's investigators were those of Philadelphia, Connecticut, Chicago, Boston, Baltimore, Cincinnati, St. Louis, Minneapolis-St. Paul, and New York.

On the basis of its studies in these milksheds the Federal Trade Commission concluded that independent auditing of handlers' books was necessary to insure sound competitive practice among them and fair and honest relationships between handlers and producers. In its summary report the Commission states that "Reports and adequate audits of milk utilization are essential to all milk settlement plans wherein the use made of the milk is the basis for arriving at prices to be paid producers."^{6/} Also, "In markets where the use made of milk by the distributors determined the prices paid to producers, reports by distributors as to proportions of milk sold or used in the many classes generally have not been properly verified by thorough audits of distributors' books to determine whether producers have received in return correct blended prices for milk."^{7/}

In the absence of adequate audits the Federal Trade Commission's investigators discovered that a variety of devices were resorted to by many handlers which had the effect of increasing their own margins and depressing the returns to producers. Among the abuses listed in the Commission's reports were (1) the purchase of milk for use in one class and actual utilization in a higher class, (2) the standardization and reconstruction of milk, and (3) interhandler sales at prices violating those in the existing marketing agreement.

1. Use in higher class than reported.— In order to find out the extent of the practice among Philadelphia handlers of purchasing milk for one class and using it in a higher class, the Commission examined the records of 16 companies for the month of October 1934. The records of five of these companies did not show transactions for all classes. The amount of underpayments to producers by these five companies was as follows:^{8/}

Class I sales.....	1,494,069 quarts
Milk purchased at Class I price.....	1,314,325 "
Class I sales in excess of Class I purchases.	179,744 "
Underpayment:	
Total.....	\$5,365.53
Per quart on all Class I sales.....	.359 cents
Per quart on excess Class I sales.....	2.985 "

^{5/} Federal Trade Commission, Summary Report of Conditions with Respect to the Sale and Distribution of Milk and Dairy Products, 1937, p. 2.

^{6/} Ibid, p. 24.

^{7/} Ibid, p. 32.

^{8/} Federal Trade Commission, Sale and Distribution of Milk Products in Connecticut and Philadelphia Milksheds, April 1935, p. 74.

The records of the other 11 companies which showed milk transactions for all classes disclosed the following excess of Class I sales over purchases: 9/

Class I sales.....	18,713,397	quarts
Milk purchased at Class I price.....	18,304,337	"
Class I sales in excess of Class I purchases.	409,060	"
Amount bought as Class II.....	402,384	"
Amount bought as Class III.....	6,676	"
Underpayment:		
Total.....	\$10,562.61	
Per quart on all Class I sales.....	.056	cents
Per quart on excess Class I sales.....	2.58	cents

Underpayments to producers by these 16 Philadelphia companies for October 1934 amounted to \$15,928.15 which was .079 cents per quart on all Class I sales, or 2.705 cents per quart on Class I sales in excess of Class I purchases.10/

The Commission's investigation in Connecticut disclosed that a handler in this area purchasing on a utilization basis had underpaid his producers for the month of June 1934 by selling more Class II milk than he purchased. The figures for this company were as follows:11/

Class II sales.....	308,305	quarts
Milk purchased at Class II price.....	216,889	"
Class II sales in excess of Class II purchases..	91,416	"
Underpayment:		
Total.....	\$314.47	
Per quart on all Class II sales.....	.102	cents
Per quart on excess Class II sales.....	.344	"

2. Standardizing and reconstructing milk.- Among the practices which may be used by handlers as a means of depressing returns to producers is the standardizing and reconstructing of milk. Standardizing is the mixing together of milk or cream of different butterfat tests in order to secure milk or cream of a uniform, desired butterfat test. Reconstructing is the practice of making milk from some combination of cream, water, skim, or condensed skim. Both of these practices may result in the sale of a greater quantity of fluid (Class I) milk than is purchased from producers.

In regard to standardizing milk, the Commission reported that this practice was quite prevalent among handlers in Philadelphia. The report stated that, "Among the regulations affecting milk dealers which are not enforced is the prohibition against standardizing milk. Most dealers probably violate this prohibition in Philadelphia and the fact is no doubt

9/ Ibid, pp. 74-75.

10/ Ibid, p. 75.

11/ Ibid, p. 75.

known to the law enforcement officials. In that city it is the practice for dealers to cut down the butterfat content of their milk by adding skim. This is done because the average butterfat content of milk received in that area is high and it is also regarded by the dealer as important that the day-to-day fat content be uniform so that the cream line will not vary."^{12/}

The Commission also found evidence of handlers having sold reconstructed milk in the Connecticut and Philadelphia markets, the report stating, "In both Connecticut and Philadelphia a few dealers were found who made milk from some combination of cream, water, skim, or condensed skim, and sold it as fluid milk without its being labeled as reconstructed milk.... The dealers in question were engaged in this practice as a part of their regular business, deriving additional revenue from this source."^{13/}

The Commission also found the practice of standardizing milk operating to depress returns to producers in the Boston market. The report of the Commission states, "The two Boston distributors covered by the inquiry sold two or more brands or grades of milk, each having a particular butterfat test standard. As the butterfat test of milk purchased varied, it was necessary to standardize the milk to obtain the butterfat standards desired for each of these grades or brands. Beginning in June 1935 and continuing through February 1936, the two distributors considered 315,981 quarts of cream as used in the standardizing process, and then deducted the same quantities of milk to be paid for at the Class I price. The net effect of this practice was to force 315,981 quarts of producers' milk from Class I into Class II. Milk returns to producers, therefore, were depressed by the difference between Class I and Class II prices."^{14/}

The Commission pointed out in its report that this practice was carried on in spite of the vigorous opposition of the Boston Milk Market Administrator who interpreted the license to mean that distributors were to pay the Class I price for "a quantity of milk equal to the quantity of their Class I sales." The administrator calculated the amount of the underpayment to producers resulting from the practice and this amount was paid to the administrator by the New England Dairies, Inc., the sales agency which represented the majority of the producers selling milk to the two distributors. The Commission reported that "records of the two distributors, however, did not show payments to the New England Dairies, Inc., to reimburse the latter for the amount of the alleged underpayment."

The Commission calculated the amount of the depressed returns to producers for the months of June 1935 through February 1936, inclusive,

^{12/} Ibid, p. 75.

^{13/} Ibid, p. 75.

^{14/} Federal Trade Commission, Distribution and Sale of Milk and Milk Products in Boston, Baltimore, Cincinnati, and St. Louis, June 1936, p. 129.

the results of this practice of standardizing milk by the two distributors for these nine months being as follows:^{15/}

Amount of milk involved.....	315,981 quarts
Average number of producers.....	6,726
Underpayment:	
Total.....	\$13,184.71
Amount per quart.....	4.17 cents
Amount per producer.....	\$1.96

3. Interhandler sales.— Among the provisions necessary to the regulation of orderly milk marketing are those relating to sales of milk from one handler to another. Unless the price at which these sales take place is prescribed by agreement between handlers and producers or by the administering body in the market, it is possible for some handlers to obtain an advantage in securing their supplies at lower prices. Order No. 17 of the Pennsylvania Milk Control Board established minimum prices to apply to milk sold at wholesale by a handler to any other handlers. The Commission found that at least one Philadelphia handler was selling bottled milk to other handlers at prices which were lower than those established in the board's order. Table 5 shows the amounts below those set by the board at which this handler sold bottled milk to four other handlers.

4. Conclusion of Federal Trade Commission regarding handlers' reports and audits.— The Commission in its June 1936 report included a general statement regarding the type of audit essential to the proper administration of any milk market:

"In order that producer cooperatives and regulatory agencies can be assured, as far as is possible by sound accounting methods, that distributors have paid producers according to the prevailing agreements or regulations the Commission considers it fundamental that the distributors' books be audited periodically. A thorough audit, assuming, of course, that adequate records are kept, would disclose the quantities of milk sold in each established sales class. To make sure that such quantity data have been determined in accordance with the prevailing agreements or regulations it is necessary to reconcile the quantities sold with respective dollar sales that appear in the profit and loss statement for the period audited. Without the reconciliation of quantity and dollar sales auditors cannot be certain that quantity sales by each class have been properly accounted for."^{16/}

^{15/} Ibid, p. 130.

^{16/} Federal Trade Commission, Distribution and Sale of Milk and Milk Products in Boston, Baltimore, Cincinnati, and St. Louis, June 1936, pp. 140-141.

Table 5.- Prices on interhandler sales of bottled milk by one Philadelphia handler to four other handlers, October 1934

Total sales in quarts to four handlers	Resale price per quart set by board	Actual sales prices per quart	Amount below board price	
			Per quart	Total
Quarts	Dollars	Dollars	Dollars	Dollars
1,104	.09	.0675	.0225	24.84
1,332	.09	.0675	.0225	29.97
1,188	.09	.0675	.0225	26.73
972	.09	.0675	.0225	21.87
648	.09	.0675	.0225	14.58
60	.09	.08	.01	.60
75	.09	.08	.01	.75
30	.09	.08	.01	.30
896	.09	.075	.015	13.44
888	.09	.075	.015	13.32
504	.09	.075	.015	7.56
1,128	.09	.075	.015	16.92
1,176	.09	.075	.015	17.64
2,319	.09	.065	.025	57.98
3,160	.09	.065	.025	79.00
2,753	.09	.065	.025	68.83
1,539	.09	.065	.025	38.48
2,277	.09	.07	.02	45.54
12	.09	.07	.02	.24
630	.09	.0825	.0075	4.73
529	.09	.0825	.0075	3.97
471	.09	.0825	.0075	3.53
543	.09	.0825	.0075	4.07
320	.09	.0825	.0075	2.40
24,554				497.29

Federal Trade Commission, Sale and Distribution of Milk Products in Connecticut and Philadelphia Milksheds, April 1935, p. 81.

IV

COMPATIBILITY OF GOVERNMENT AUDIT WITH
HANDLERS' INTEREST IN PRIVACY OF RECORDS

Some handlers have opposed the right of the Government to audit and otherwise have access to their books and records on the ground that this constitutes an unwarranted interference with the privacy of their business. The claim is made that the handler has a right to keep his own records secret so that outsiders will not have knowledge of his methods of operation. In answer to this argument it can be stated that the Government's right of entry is inseparable from its right to regulate, the former being justified insofar as it is necessary to, or facilitate the latter. Furthermore, such information is kept confidential by the Federal Government and only released in the form of summaries which do not disclose the operations of individual handlers.

The evidence presented in the foregoing sections demonstrates conclusively that the efficiency of regulation of milk marketing by the Government would be seriously impaired if the Government did not exercise the right of access to handlers' records and carry out regular audits. Unless the administrator for a milk market was able to discover violations of the agreement or order he would be powerless to administer its provisions. A relatively few handlers could then disrupt the orderly marketing process which Congress sought to achieve in enacting the Agricultural Adjustment Act and the subsequent Agricultural Marketing Agreement Act of 1937.

For the purpose of assuring handlers that their legitimate private interests in their records would not be infringed, the following provision was written into the Agricultural Adjustment Act and reenacted in the Agricultural Marketing Agreement Act of 1937.^{17/}

"Notwithstanding the provisions of section 7, all information furnished to or acquired by the Secretary of Agriculture pursuant to this section shall be kept confidential by all officers and employees of the Department of Agriculture and only such information so furnished or acquired as the Secretary deems relevant shall be disclosed by them, and then only in a suit or administrative hearing brought at the direction, or upon the request of the Secretary of Agriculture, or to which he or any officer of the United States is a party, and involving the marketing agreement or order with reference to which the information so to be disclosed was furnished or acquired. Nothing in this section shall be deemed to prohibit (A) the issuance of general statements based upon the reports of a number of parties to a marketing agreement or of handlers subject to an order, which statements do not identify the information furnished by any person, or (B) the publication by direction of the Secretary, of the name of any person violating any marketing agreement or any order, together with a statement of the particular provisions of the marketing agreement or order violated by such person. Any such officer or employee violating the provisions of this section shall upon conviction be subject to a fine of not more than \$1,000 or to imprisonment for not more than one year, or to both, and shall be removed from office."

^{17/} Section 8d.(1) of the Agricultural Marketing Agreement Act of 1937.

DECLARATION OF THE PRINCIPLES OF THE
FEDERAL GOVERNMENT OF THE UNITED STATES

That the people of the United States, in order to form a more perfect Union, establish Justice, insure domestic Tranquillity, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do hereby declare the following Principles of the Federal Government of the United States to be the basis of the same.

1. The Federal Government of the United States shall be a Union of free, sovereign, and independent States, each of which shall retain the right of self-government, and the right to alter or amend the Federal Constitution.

2. The Federal Government of the United States shall be a Union of free, sovereign, and independent States, each of which shall retain the right of self-government, and the right to alter or amend the Federal Constitution.

3. The Federal Government of the United States shall be a Union of free, sovereign, and independent States, each of which shall retain the right of self-government, and the right to alter or amend the Federal Constitution.